

New Jersey Economic Insights

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Outlook New Jersey

New Jersey Jobs Numbers Show Moderate Improvement

New Jersey

The number of New Jersey jobs in April grew by 4,500, with an increase of 3,300 in the private sector. While the monthly gain can be characterized as moderate, it was insufficient to reverse more than a portion of the recent softness, and the number of jobs in the state remained below the level of last November's. The hard winter certainly had some impact on the state's job count, and it's possible that even with the marked improvement in the weather in April, it will take a few months to shake off its effects.

The April numbers on resident employment and the unemployment rate were much brighter. The unemployment rate fell to 6.9%, which is its lowest level since November 2008. The decline in the rate from March's 7.2% resulted from a marked 17,300 increase in the number of state residents who reported that they were employed. At the moment, this increase in resident employment (which is not necessarily equal to the number of jobs in the state) stands as the largest monthly gain in 30 years.

- *New Jersey unemployment has fallen to a multi-year low, though job growth remains sluggish.*
- *The national economy is starting to turn up after the harsh winter.*

In other state data, home sales continue to track below 2013 monthly rates, apparently the effect of both the lingering impact of the winter and limited supply in some regions. In contrast, housing permits continue to move up strongly. Over the first four months of 2014, the aggregate number of permits granted in New Jersey were 30.6% greater than in the same months of 2014, and higher than any January-April since 2006. New car sales were 8.4% higher this April than April 2013, and were higher than any month since June 2007. The coincident indexes of state activity compiled by the New York and Philadelphia Federal Reserve Banks show modest gains, reflecting the recent softness in jobs. However, the Philadelphia Fed's regional manufacturing survey—which includes South Jersey firms—showed considerable forward momentum in both April and May.

In sum, while the state's numbers are basically mixed, they are, overall, somewhat better than was the case in the depths of the winter, and are

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hopefully pointing to some near-term improvement.

U.S. Economic Outlook

U.S. economic data also has been mixed, but points to a spring upturn. The GDP numbers show that output fell at a 1.0 percent annual rate in the first quarter. The drop — the first in three years — partly reflected the direct hit the harsh winter put on construction and discretionary consumer spending. Also weighing on GDP was a downturn in capital spending and weak foreign demand, which dragged down exports. Finally, businesses cut back sharply on their accumulation of inventories.

Going into spring, the national job numbers are showing marked improvement, with the monthly increases soaring from 84,000 in December to April's 288,000, which was the biggest gain in over two years. The national unemployment rate fell to 6.3% in April (the current 0.6 point gap between New Jersey's unemployment rate and the national one is now less than half of September 2012's 1.6 points). Retail sales were flat in April,

but that followed strong gains in February and March. Housing starts and sales appear to be starting to rebound after recent reverses reflecting the harsh winter and last year's increases in mortgage interest rates. Manufacturing output also appears to be picking up after winter interruptions, though April saw a modest decline.

Outside the United States, conditions in Europe and, especially, China appear to be softening. Thus, while a growth rebound in the U.S. seems to be in the works, the outlook for the rest of the world is less robust.

Recent inflation numbers have moved up a touch, but are still quite low by any long-term standard. In this environment, with the U.S. just starting to emerge from the most recent "soft patch" and international conditions problematic, the Federal Reserve continues to signal its great reluctance to increase short-term interest rates, even though the Fed almost surely will continue on its now hard-set path of reducing its volume of monthly purchases of long-term securities.

Economic Analysis

April Revenue Surprise Hits N.J., and Several Other States

New Jersey's income tax revenue in April 2014 was far below both the amount collected in April 2013 and the amount targeted by the Treasury Department. The shortfall was sufficiently large to necessitate immediate substantial cuts in spending to balance the state budget for fiscal year 2014 (which ends on June 30), and also implies that resources available to fund spending in fiscal year 2015 will be considerably less than thought when the Governor's budget proposal was made in February.

Why did April revenues fall so much? The answers, we believe, have little or nothing to do with events affecting the recent trends in the state's economy, such as the harsh winter, any after effects of Sandy, or the recent softness in jobs. The shortfall appears to have reflected unexpectedly large responses of high-income taxpayers to the January 2013 increases in federal tax rates.

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To refresh everybody's recollection, two federal tax increases were pending as 2012 grew to an end. Regular income tax rates were scheduled to return to the 2000

schedule, which meant a very substantial rise at the top. In addition, the tax provisions of the Affordable Care Act (ACA) would go into effect on Jan. 1, 2013. A key provision was the introduction of a new 3.8% tax on capital income (dividends, rents, interest, and capital gains) for taxpayers earning more than \$250,000 a year. These funds would be placed in the Medicare trust fund.

After considerable negotiation in Washington, D.C., agreement was reached at the turn of the year, and the top rate on regular income rose from 35% to 39.5%, and the income tax rates on dividends and capital gains rose

from 15% to 20%. With the additional ACA tax coming on line, the overall federal tax rate on dividends and capital gains for high-income taxpayers went from 15% to 23.8%.

The upshot was that in late 2012, high-income taxpayers saw that their federal taxes, particularly on capital income, would rise substantially in the New Year. Many of these individuals were in a position to realize income before the end of 2012, and thus avoid paying the higher rates. As a result, late 2012 saw unusually large payments of bonus income and dividends and large sales of appreciated assets to realize capital gains. All of these actions worked to increase 2012 taxable income and were reflected in atypically large receipts of income tax revenues by New Jersey (and all other states with income taxes) in late 2012 and early 2013, particularly during the period after April 15 when final payments were received.

It was always understood that much of the surge in revenues in April 2013 was not sustainable; clearly, the well-to-do had pushed forward a great deal of income, particularly capital gains, from calendar year 2013 back to calendar year 2012. All states with income taxes anticipated that April 2014 revenues would not see the growth seen in April 2013.

However, during 2013 the stock market grew exceedingly rapidly. Bull markets of that magnitude would normally be associated with increases in capital gains, working to offset tax-related reductions. At least here in New Jersey we observed strong gains in estimated tax payments around the quarterly payment dates in September 2013 and January 2014. If estimated tax payments are strong, it is plausible to anticipate that the tax liabilities of those who make estimated payments will grow, and that final payments will also increase. Thus, entering April 2014 we believed that final payments would be

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at or above their April 2013 levels.

Of course, final payments in April 2014 were substantially less than in April 2013, creating the major shortfall in income tax and overall revenue for Fiscal Year 2014. New Jersey was not alone in failing to see the magnitude of the payback from the 2013 revenue surge. As best as we can tell, nearly all states saw final payments fall substantially short of expectations, and Connecticut saw a shortfall that was proportionately comparable to ours.

The harsh lesson of this episode is the exceeding difficulty of anticipating tax-related behavior of a relatively small number of individuals. The number of New Jersey taxpayers for whom these considerations were important numbers, at most, number a few tens of thousands, out of the four million who file state income taxes.

A major challenge is that there is no reliable way to

gauge the behavior of this group over the course of the year, except, as noted, by observing estimated tax payments.

Capital gains, unlike other types of taxable income (especially wages), is not tracked by any statistics over the course of a year, so there is no direct information on developments until tax returns are filed.

As the Treasurer has noted numerous times, New Jersey's unusually strong dependence on income tax payments from the high income group makes us peculiarly vulnerable to events like this. State revenues are greatly influenced by a component of income tax that is highly volatile, hard to predict and even hard to observe until late in a fiscal year.

— *Charles Steindel, Chief Economist, The Department of the Treasury*



New Jersey Business Pulse Survey

March/April Business Pulse Survey Results

The New Jersey Business Pulse survey includes 14 questions about current and prospective conditions in New Jersey and the nation and allows respondents to give their views on other topics of their choice. Forty-two firms responded to the March survey and 40 responded to the April survey. Detailed results from these and past surveys can be found at <http://www.state.nj.us/treasury/economicsurveyresults.shtml>.

The website also contains charts and tables summarizing the results, as well as an explanation on how indices are constructed from answers to the questions.

Outlook for New Jersey Business Conditions and Revenues

More New Jersey firms reported feeling confident about current and future business conditions. Notably, more firms were confident about the business climate inside New Jersey than outside the state when compared to a year ago. The number of firms reporting that they expect higher revenues outside New Jersey remained essentially unchanged but those expectations among in-state establishments edged higher.

New Jersey Firms are Hiring More

More business owners reported having plans to do additional hiring inside New Jersey than outside the state compared to a year ago. Since October of last year this number has seen a steady increase, suggesting strong expected revenue growth for these firms. More employers reported difficulty finding qualified job candidates in

New Jersey than elsewhere, but this gap has shrunk considerably compared to April of 2013.

In-State Capital Spending Encouraging

Capital spending plans increased among New Jersey-based establishments but fell among those in other parts of the country. Since the start of the survey in April 2011 (except briefly in July 2013), the number of firms reporting plans for increased capital spending in New Jersey has not reached this level.

Prices Charged and Paid

Most firms reported that they did not charge more for their products and services in March/April 2014, but the percentage that hadn't done so represents a decline from last April. The proportion of firm owners that reported paying more for goods and services increased within the last year.

Conclusion

The Business Pulse survey results for March/April suggest growing confidence among New Jersey business owners about the state's business climate. The prospects for future employment and growth are promising despite the impacts of a severe winter in the first quarter of 2014.

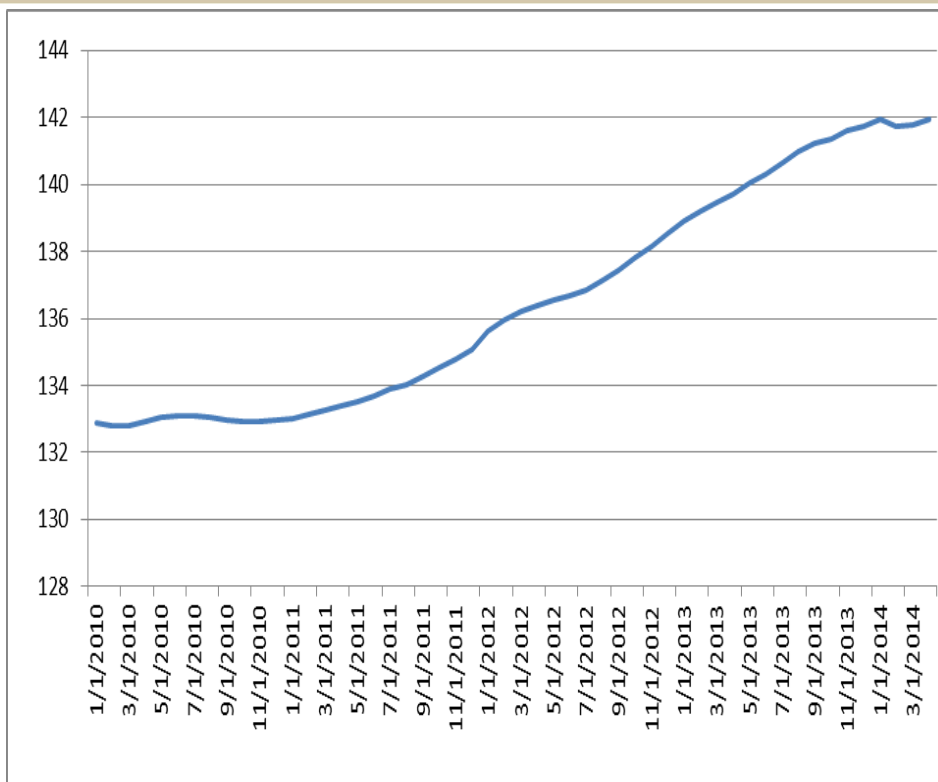
-Noel Popwell

Garden State Activity Index

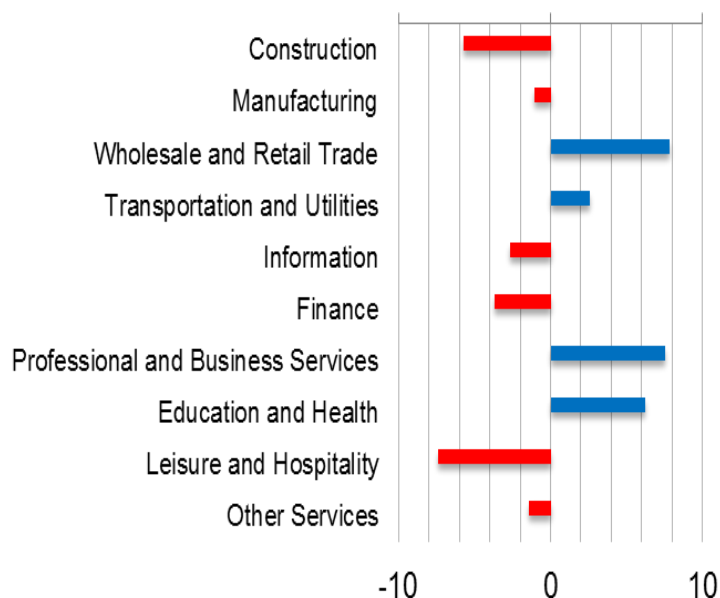
The Garden State Activity Index is our broad measure of monthly economic activity in the state of New Jersey. The index incorporates information from three sources: the Federal Reserve Bank of New York's coincident index, the Federal Reserve Bank of Philadelphia's coincident index and the Philadelphia Fed's South Jersey Business Survey.

To construct the Activity Index we use principal components analysis, which takes a weighted average of the three indicators. The composite index reflects the current state of the New Jersey economy.

New Jersey's economy grew at a slower pace in the first quarter, reflecting the unusually harsh winter. The Activity Index has grown 6.8 percent since the beginning of 2010 and about 1.6 percent over the last year.— *Noel Popwell*

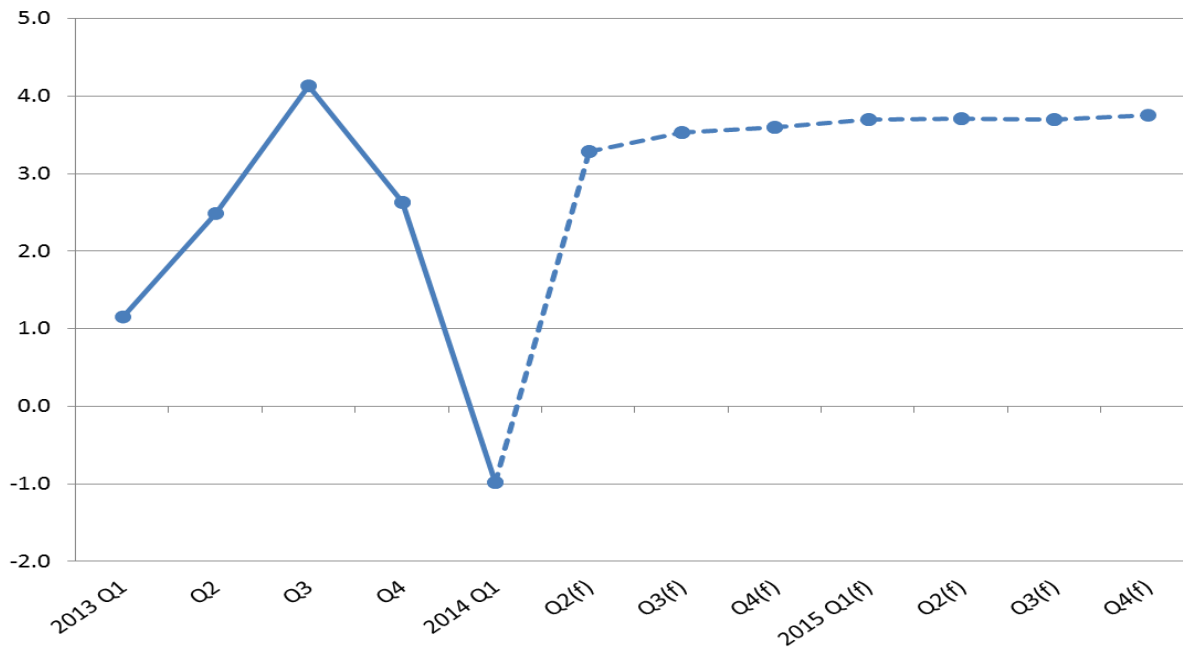


Private Industry Employment Trends



Change in Thousands of Jobs
February–April 2013 to February–April 2014

Real U.S. GDP Growth



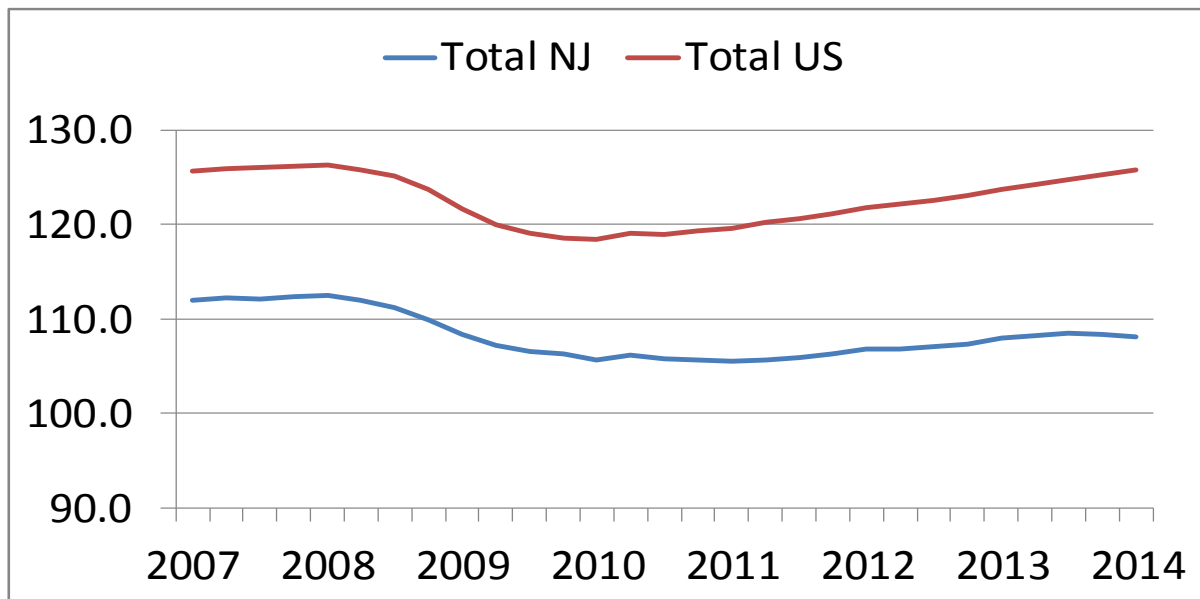
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Data source: U.S. Bureau of Economic Analysis

State & National Job Trends

Total Employment (Relative Employment 1990=100)

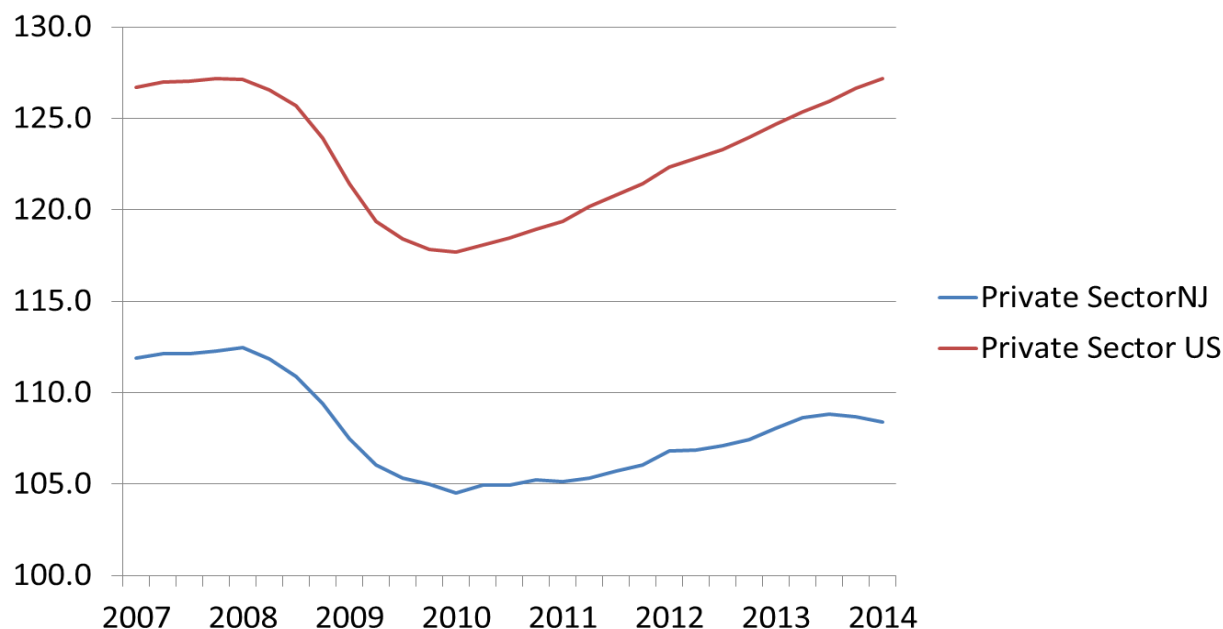
This chart compares the number of employed workers to the base year of 1990. The number 100 represents employment in 1990.



State & National Job Trends

Private Sector Jobs *(Relative Employment 1990=100)*

This chart compares the number of employed workers to the base year of 1990. The number 100 represents employment in 1990.



Data source: U.S. Bureau of Labor Statistics, New Jersey Department of Labor

Explanatory note: These charts track trends in total and private sector employment in New Jersey and compare them with those of the nation as whole measured against a 1990 baseline.

Disclaimer

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